UNITED STATES OF AMERICA
RAILROAD RETIREMENT BOARD
844 NORTH RUSH STREET
CHICAGO, ILLINOIS 60611-2092

Bureau of the Actuary

April 12, 2007

Wendy M. Comes, Executive Director
Federal Accounting Standards Advisory Board
441 G Street NW, Suite 6814 (Mailstop 6K17V)
Washington, DC 20548

Dear Ms. Comes:

Thank you for the opportunity to provide our comments with respect to the Statement of Federal Financial Accounting Standards Preliminary Views on Accounting for Social Insurance, Revised dated October 23, 2006.

Both the primary and alternate views (on pages 20 and 39) distinguish between the social security equivalent portion and the rail pension portion of railroad retirement benefits. Since it is our understanding that the provisions of the statement would apply only to the social security equivalent portion, our comments are limited to those benefits. Although we agree that social security equivalent benefits represent a social insurance expenditure and would favor recording a liability only for benefits that are due and payable, for reasons set forth below, we believe it would be more appropriate to classify such benefits as a liability of the social security system, rather than the railroad retirement system.

The financing provisions of the railroad retirement system are unique. Section 7(c)(2) of the Railroad Retirement Act of 1974 requires a financial interchange between the railroad retirement and social security systems in order to place the Social Security Old-Age and Survivors Insurance and Disability Insurance Trust Funds and the CMS Hospital Insurance Trust Fund in the same condition they would have been had railroad employment been covered under the Social Security and Federal Insurance Contributions Acts. Every year as part of the comprehensive financial interchange, estimates are made of the additional benefits and administrative expenses that would have been paid from those trust funds over the prior year, as well as the additional payroll taxes and income taxes that would have been received by them over the prior year, with allowances for interest. The net result of this mechanism is that the social security system bears the same net cost whether an employee works for a railroad or any other employer, and the railroad retirement system bears no net cost for social security equivalent benefits.

The actual workings of the financial interchange may best be illustrated by an example. Consider an employee who retires in 2007 at age 65 after working 40 years, the last 5 years of which were for a railroad. During the employee's 35 years of non-railroad work, employee and employer payroll taxes would have been paid to the social security system. During the employee's 5 years of railroad work, social security equivalent (tier 1) employee and employer payroll taxes would have been paid to the railroad retirement system and then in turn credited to the social security system through the financial interchange.

Once the employee retires, the RRB calculates a social security equivalent benefit based on the employee's entire 40-year earnings history. Even if the 5 years of railroad work are drop-out years in the high 35 years calculation and thus do not affect the benefit, the RRB will still administer payment of the benefits. Each month the RRB is required to borrow from the Department of the Treasury an amount equal to the employee's social security equivalent benefit. (For the population as a whole, the RRB borrows the net of benefits and administrative costs over tax income each month.) The purpose of this borrowing is to prevent cash flow problems that may arise from the timing of financial interchange transfers. Once each year, the RRB charges the social security system for these benefits and administrative costs through the financial interchange and receives payment with interest. On the same day, the RRB repays Treasury with interest. As a result, there is not only no cost to the RRB for social security equivalent benefits, but also the borrowing and repayment mechanism required by Section 7(c)(4) of the Railroad Retirement Act of 1974 prevents any short term cash flow problems that may otherwise arise from the timing of the payments.

The net effect of the financial interchange is that the social security system is not affected by whether an employee works for a railroad or any other employer, and although the railroad retirement system administers the payment of social security equivalent benefits, it does not bear any cost for these benefits. Just as a private employer who has paid payroll taxes to the social security system does not report a liability for social security benefits, so too the RRB should not report a liability for social security equivalent benefits. That these amounts should be reported by the Social Security Administration is also evidenced by the inclusion of transfers to the RRB in the social insurance disclosures of SSA's current Performance and Accountability Report.

Although the RRB may make up the difference between full SSEB benefits and the level paid by SSA in the event that SSA is unable to pay full benefits, these payments would not relieve SSA of any obligation. Our estimates are based on the provisions of law being fulfilled and do not provide for this contingency which is (1) not estimable by the RRB, (2) relatively insignificant in relation to the full level of SSEB benefits, and (3) unlikely to occur without prior corrective action by Congress.

Reporting liabilities related to social security equivalent benefits on the RRB financial statements may give the false impression that the ability to fund these liabilities is dependent on the assets or future income of the railroad retirement system. These liabilities in fact bear little relation to railroad retirement assets or income. Even if rail employment ceased and railroad retirement assets were completely depleted, social security equivalent benefits would continue to be paid due to the financial interchange between the railroad retirement and social security systems.

Accordingly, we respectfully request the FASAB to remove the RRB from the list of entities subject to the provisions of the Statement of Social Insurance.

Sincerely,

Frank J. Buzzi

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Chief Actuary